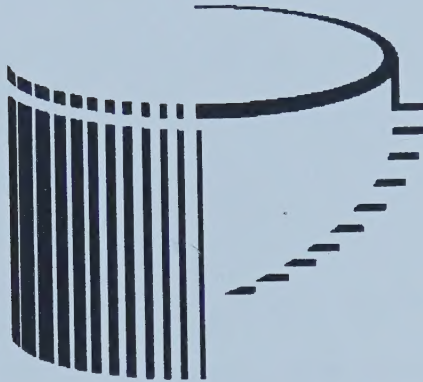


AR61

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University of Alberta
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Edmonton, Alberta T6G 2R6

PRIZE

ENERGY INC.



1996 ANNUAL REPORT

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The 1996 annual meeting of Prize Energy Inc. will be held at 3:00 P.M. on December, 20,
1996 at the Law Offices of McCarthy Tetrault, 3200, 421-7th Avenue S.W., Calgary,
Alberta

Message to Shareholders:

New Board of Directors and Cost Reductions

1996 was a year of consolidation and change for Prize Energy Inc. The Company's remaining producing assets were sold, and Prize exited the year with working capital of \$2.4 million. At the end of the fiscal period Prize's Board of Directors and Management resigned. A new Board of Directors consisting of myself, Frank Curley, Greg Noval and Robert Pilling was appointed. In addition, I assumed the responsibilities of President and Secretary of the Company. The result of these changes was to virtually eliminate general and administrative costs (1996-\$339,000), as no salaries or Director's Fees are being paid at the current time. One benefit of this streamlining is that Prize is expected to return to a profitable position in the 1997 fiscal year, in spite of having virtually no production revenue at the present time.

Exploration Activity

Prize's principal exploration asset, at Waterton, was farmed-out to Canadian 88 Energy Corp. during the year. Prize has retained a 10% carried interest in the drilling of the first five wells on the prospect. The exploration well at Waterton (8-18-7-2 W5) was spudded in March, 1996, and in late August of 1996, Canadian 88 Energy Corp. announced that the logs of the primary Mississippian objective indicated the likelihood of a major natural gas, natural gas liquids and sulphur discovery. Through drilling the well (at a cost to Canadian 88 in excess of \$7,000,000), an interest was earned in a 13.5 section exploration block encompassing a large, seismically-defined anomaly. Subsequent to logging the Mississippian, Canadian 88 deepened the well to approximately 4400 meters in order to evaluate the potential of a secondary Devonian objective. At this time the well has been drilled to total depth and testing of both the Devonian and Mississippian Formations is expected to be underway in October. An 80 square mile 3-D seismic survey is being

conducted over the prospect in order to high-grade development locations, the first of which is expected to be spudded in the near future.

Other exploration assets have been examined, and at this time Prize is evaluating either drilling or farming-out a 100% owned Keg River Reef oil prospect in the Shekile area of northern Alberta.

We have not been able to satisfy ourselves regarding the viability of any of the Company's other exploration assets at this time.

Looking Ahead

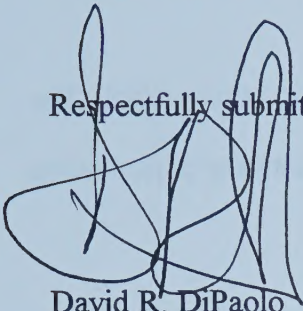
Recovering from a disastrous initial full year of operations, Prize is positioned with cash, an interest in a large discovery at Waterton, and a strong strategic partner and controlling shareholder (Canadian 88 Energy Corp.).

Last year a merger with Post Energy Corporation was averted, partially through my efforts, which would have resulted in a dilution of the Prize shareholders working interest in the Waterton play to an effective level of just 3%. By working to set this proposed Plan of Arrangement aside, and through the good fortune of what appears to be an extraordinarily successful discovery at Waterton, significant value has been added to Prize over the past several months.

Numerous challenges face us in the forthcoming year however. Prize is sorely lacking in exploration prospects and in-house technical expertise at the present time. Our Board of Directors is currently examining a number of alternatives at this time to address these challenges. These include: staffing up; the sale of the Company; the acquisition of a portfolio of exploration and production assets; or entering into a formal exploration joint-

venture with Canadian 88 Energy Corp. No determination as to the most constructive course of action has been made at this time.

Respectfully submitted on behalf of the Board of Directors

A handwritten signature in black ink, appearing to read 'David R. DiPaolo', written over the typed name.

David R. DiPaolo

President

Management's Discussion of Financial Results

Revenue

Oil and gas revenues declined 92% to \$114,500 in 1996 from \$1,630,000 in 1995. The decline is largely attributable to the sale of virtually all of the Company's producing properties in 1996, and to a lesser extent, lower natural gas prices.

Net Loss

Prize posted a deficit of \$157,000 in 1996, compared to a deficit of \$6,051,000 in 1995. The 1996 loss is attributable to general and administrative expenses and depletion and depreciation charges both exceeding revenues by a wide margin. In the 1997 fiscal period, both of these costs have been largely eliminated. The 1995 loss was largely attributable to a \$5,739,000 loss on the sale of an oil and gas property.

Liquidity and Capital Resources

At year end 1996, Prize's working capital position was \$2,268,000, with no long term debt. At year end 1995, the Company had a working capital deficit of \$241,000 and long term debt of \$188,000. The improved liquidity resulted from the sale of the Company's production during the 1996 period. Prize has a credit line of \$500,000 with a Canadian chartered bank. The line was unutilized at year end 1996.

AUDITORS' REPORT

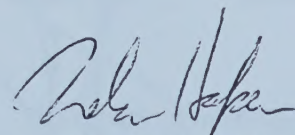
To the shareholders of Prize Energy Inc.

I have audited the balance sheets of Prize Energy Inc. as at May 31, 1996 and May 31, 1995 and the statements of operations and deficit and changes in financial position for each of the years then ended. These financial statements are the responsibility of the Company's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audits in accordance with generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at May 31, 1996 and May 31, 1995 and the results of its operations and the changes in financial position for each of the years then ended in accordance with generally accepted accounting principles. As required by the British Columbia Act, I report that, in my opinion, these Principles have been applied on a consistent basis.

Calgary, Alberta
October 9, 1996



Chartered Accountant

Prize Energy Inc.
Balance Sheet
As at May 31

ASSETS

	<u>1996</u>	<u>1995</u>
Current		
Cash and short term investments	\$ 2,337,677	\$ -
Accounts receivable	58,080	66,808
Prepaid expenses	3,982	4,284
Due from shareholders (Note 2)	<u>-</u>	<u>101,690</u>
	2,399,739	172,782
Capital assets (Note 3)	410,482	3,435,862
Deposits	<u>15,500</u>	<u>16,410</u>
	\$ <u>2,825,721</u>	\$ <u>3,625,054</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

Current		
Accounts payable and accrued liabilities	\$ 131,605	\$ 413,979
Long term debt (Note 4)	-	187,528
Provision for future site restoration costs	<u>3,537</u>	<u>2,911</u>
	135,142	604,418
Shareholders' equity		
Share capital (Note 5)	8,898,760	9,071,560
Retained earnings (deficit)	<u>(6,208,181)</u>	<u>(6,050,924)</u>
	2,690,579	3,020,636
	\$ <u>2,825,721</u>	\$ <u>3,625,054</u>

Approved by the board:

Director

Director

Prize Energy Inc.
Statement of Earnings and Deficit
For the Years Ended May 31

	<u>1996</u>	<u>1995</u>
Revenue		
Oil and natural gas sales	\$ 150,729	\$ 1,897,394
Royalties	(15,298)	(370,992)
Alberta royalty tax credit	<u>(20,931)</u>	<u>136,548</u>
	114,500	1,662,950
Interest income	<u>112,425</u>	<u>4,672</u>
	<u>226,925</u>	<u>1,667,622</u>
Expenses		
General and administrative	383,680	248,730
Operating	57,518	716,889
Interest on long term debt	6,600	99,188
Depletion and depreciation (Note 3)	<u>663,707</u>	<u>604,747</u>
	<u>1,111,505</u>	<u>1,669,554</u>
Earnings (loss) before the following:	(884,580)	(1,932)
Gain (loss) on disposal of oil and gas properties	<u>727,323</u>	<u>(5,738,878)</u>
Net loss before income taxes	(157,257)	(5,740,810)
Deferred income taxes	<u>-</u>	<u>310,114</u>
Net loss for the year	(157,257)	(6,050,924)
Retained earnings (deficit), beginning of year	<u>(6,050,924)</u>	<u>-</u>
Retained earnings (deficit), end of year	\$ <u>(6,208,181)</u>	\$ <u>(6,050,924)</u>
Net (loss) per share	\$ <u>(0.006)</u>	\$ <u>(0.25)</u>

Prize Energy Inc.
Statement of Changes in Financial Position
For the Years Ended May 31

	<u>1996</u>	<u>1995</u>
Operating activities:		
Net (loss) for the period	\$ (157,257)	\$ (6,050,924)
Add (deduct) items not involving cash:		
Depletion and depreciation	663,707	604,747
Deferred income tax	-	310,114
(Gain) loss on disposal of oil and gas properties	<u>(727,323)</u>	<u>5,738,878</u>
	(220,873)	602,815
Net change in non-cash working capital items	<u>(271,808)</u>	<u>98,086</u>
	<u>(492,681)</u>	<u>700,901</u>
Financing activities:		
Long term debt	(187,528)	187,528
Issue of common shares	-	5,995,306
Issue of warrants	-	2,195,120
Income tax benefits renounced	(172,800)	(1,051,084)
Deferred tax benefit of share issue costs	<u>-</u>	<u>(235,846)</u>
	<u>(360,328)</u>	<u>7,091,024</u>
Investing activities:		
Acquisition of capital assets	(215,204)	(10,887,368)
Proceeds on disposal of capital assets	3,304,200	2,408,530
Advances from (to) shareholders	<u>101,690</u>	<u>(5,610)</u>
	<u>3,190,686</u>	<u>(8,489,245)</u>
Increase (decrease) in cash	2,337,677	(697,320)
Cash, beginning of period	<u>-</u>	<u>697,320</u>
Cash, end of period	\$ <u><u>2,337,677</u></u>	\$ <u><u>-</u></u>

Prize Energy Inc.
Notes to Financial Statements
For the Years Ended May 31

1. Significant accounting policies

The financial statements are prepared in accordance with generally accepted accounting principles in Canada. Among the more significant of these principles are the following:

a) Capital assets

i) Petroleum and natural gas property and equipment and deferred development expenditures

The Company follows the full cost method of accounting for petroleum and natural gas operations as set out in the Accounting Guideline on Full Costing in the Oil and Gas Industry issued by the Canadian Institute of Chartered Accountants. Under this method, all costs of acquiring, exploring for and developing petroleum and natural gas reserves, whether productive or unproductive, are capitalized. Costs include lease acquisition, geological and geophysical, exploration and development drilling, production equipment costs and overhead expenses related to exploration and development activities. The costs are depleted and depreciated on the unit of production method, based on estimated gross proven reserves of oil and natural gas. Petroleum and natural gas production and reserves are converted into equivalent units based upon the estimated relative energy content.

Proceeds from the sale of oil and gas properties are applied against capitalized costs, with no gain or loss recognized unless such a sale would significantly alter the rate of depletion and depreciation.

The Company periodically reviews the costs associated with unproved properties to determine whether they are likely to be recovered. When costs are not likely to be recovered, an impairment allowance is provided. The allowance is transferred to the full cost pool and is depleted.

The net carrying value of the Company's petroleum and natural gas properties is limited to the amount determined by estimating the value of future net revenue from proven reserves, based upon prices and costs as at the balance sheet date together with the cost of unproved properties, net of impairment allowances, less future general and administrative expenses, financing costs and taxes.

ii) Other equipment

Other equipment is recorded at cost less accumulated depreciation. The Company provides for depreciation of these assets using the declining balance method or straight line method at rates ranging from 20% to 100% per annum.

b) Joint Ventures

Where the Company's acquisition, exploration, development and production activities are conducted jointly with others, the accounts reflect the Company's proportionate interest in such activities.

c) Flow through shares and warrants

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow through warrant arrangements are renounced to investors in accordance with income tax legislation. Petroleum and natural gas properties, deferred development expenditures, and the stated value of warrants are reduced by amounts equal to the estimated income tax benefits renounced by the Company to the investors. This reduction is recorded when the exploration and development expenditures are renounced to investors.

d) **Provision for future site restoration**

Estimated future site restoration costs are provided for using the unit of production method. Costs are estimated by the Company's engineers based on current regulations, costs, technology and industry standards.

2. Due From Shareholders

The Company loaned \$93,512 to two officers of the Company. The loans are unsecured, payable on demand and earn interest at 6% per annum payable on repayment. During the year, the loans plus accrued interest were repaid in full.

3. Capital Assets

	<u>1996</u>			<u>1995</u>
	<u>Cost</u>	<u>Accumulated Depletion and Depreciation</u>	<u>Net Book Value</u>	<u>Net Book Value</u>
Petroleum and natural gas property and equipment	\$ 955,206	\$ 575,866	\$ 379,340	\$ 3,391,193
Other equipment	<u>68,518</u>	<u>37,376</u>	<u>31,142</u>	<u>44,669</u>
	<u>\$ 1,023,724</u>	<u>\$ 613,242</u>	<u>\$ 410,482</u>	<u>\$ 3,435,862</u>

During the year ended May 31, 1996, the Company capitalized \$ 192,344 of general and administrative costs (1995 - \$154,610) that were directly related to exploration and development activities. Depletion and depreciation includes a writedown of \$620,000 (1995 - NIL) to recognize the impairment of certain conventional properties.

4. Long term debt

The Company has a revolving credit facility in the amount of \$500,000 with a Canadian chartered bank. Borrowings under the line of credit bears interest at the bank's prime lending rate plus 1 1/4% and are secured by an assignment of book debts and a first floating charge debenture over all assets of the Company. Principal repayments are not required by the bank during the current operating period.

5. Share Capital

a) **Authorized**

Unlimited number of common shares
Unlimited number of preferred shares

The Company is authorized to issue 2,400,000 special D warrants at a price of \$0.95 per warrant. Each warrant will entitle the holder thereof to be issued one common share of the Company without payment of any additional consideration. All warrants outstanding on September 27, 1995 were converted into common shares.

b) Outstanding

	<u>Number</u>	<u>Stated Value</u>
Common:		
Balance, May 31, 1994	<u>2,705,716</u>	\$ <u>40,591</u>
Issued during the year:		
Conversion of Special A, B, and C warrants	12,075,000	1,891,627
Issued for cash:		
Public offering	9,500,000	6,175,000
Upon exercise of stock options	130,000	32,500
Less:		
Share issue costs, net of tax benefits	-	(212,194)
Income tax benefits renounced	-	(210,718)
Balance, May 31, 1995	<u>24,410,716</u>	<u>7,716,806</u>
Conversion of Special D warrants	2,400,000	2,280,000
Share issue costs, net of tax benefits	-	(84,880)
Income tax benefits renounced	-	(1,013,166)
Balance, May 31, 1996	<u>26,810,716</u>	\$ <u>8,898,760</u>
Special Warrants:		
Balance, May 31, 1994	12,075,000	\$ 1,891,627
Conversion of Special A, B, and C Warrants	(12,075,000)	(1,891,627)
Issued during the year for cash:		
Special D	2,400,000	2,280,000
Less:		
Issue costs, net of tax benefits	-	(84,880)
Income tax benefits renounced	-	(840,366)
Balance, May 31, 1995	<u>2,400,000</u>	<u>1,354,754</u>
Conversion of special D warrants	(2,400,000)	(2,280,000)
Issue costs, net of tax benefits transferred	-	84,880
Income tax benefits renounced transferred	-	840,366
Balance, May 31, 1996	<u>-</u>	\$ <u>-</u>
Total share capital, May 31, 1996	<u>26,810,716</u>	\$ <u>8,898,760</u>

- c) The Special A, B, and C warrants were converted into common shares in July 1994 upon qualification of such shares for distribution pursuant to a prospectus.
- d) On July 29, 1994, the Company issued 9,500,000 common shares at \$0.65 each pursuant to a prospectus for total proceeds of \$6,175,000 before share issue costs.
- e) The Company has granted share options to current and former directors and officers of the Company. As at May 31, 1996, options to purchase 100,000 (1995 - 2,150,071) common shares were outstanding. These options are exercisable at \$0.25 per share and expire on August 22, 1996. All outstanding options to purchase common shares were exercised prior to August 22, 1996.

6. Income Taxes

- a) As at May 31, 1996 and 1995 the Company had renounced certain resource expenditure deductions to the subscribers of flow through warrants and common shares. The income tax benefits foregone by the Company are estimated to be \$172,800 and \$1,051,084 respectively.
- b) The Company has income tax losses carried forward amounting to \$394,026, which may be applied to reduce future years' taxable income. The potential income tax benefit associated with these losses has not been recorded in the accounts. These losses expire as follows:

2002	\$105,019
2003	<u>289,007</u>
	<u>\$394,026</u>

- c) Based on current reserve reports and current prices, Management believes that the Company may not be taxable in the near future. Accordingly, the existing deferred tax balance has been charged to operations.

7. Commitment

The Company has an operating lease agreement for office premises in the amount of \$26,016 ending in 1997.

8. Subsequent event

In September, 1996, \$90,000 was paid to three individuals as a final settlement for their outstanding claim regarding their previous employment with the Company.

Corporate Information

Head Office

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Calgary, Alberta T2P 2V6
Tel: (403) 294-1411
Fax: (403) 294-1417

Officers and Directors

David DiPaolo,
President and Director

Frank Curley
Director

Greg Noval
Director

Robert Pilling
Director

Bankers

Bank of Nova Scotia
Calgary, Alberta

Stock Exchange Listing

Alberta Stock Exchange
Trading Symbol: PZI

Registrar and Transfer Agent

Montreal Trust Company
Calgary, Alberta

Solicitors

McCarthy Tetrault
Calgary, Alberta



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